



# Instructions for Form 1120-PC

## U.S. Property and Casualty Insurance Company

Section references are to the Internal Revenue Code unless otherwise noted.

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### Pending Legislation

At the time of printing, Congress was considering legislation affecting these instructions. Included in the pending legislation are provisions that would change the definition of a capital asset, modify the treatment of gains from constructive ownership transactions, repeal the use of the installment method for certain taxpayers, and limit the use of the nonaccrual experience method of accounting. See **Pub. 553**, Highlights of 1999 Tax Changes, to find out if this legislation was enacted, and details on the changes.

### Change To Note

New rules for determining whether the corporation must use the Electronic Federal Tax Payment System (EFTPS) to make Federal tax deposits are effective beginning January 1, 2000. See **Electronic Deposit Requirement** on page 4.

### Photographs of Missing Children

The Internal Revenue Service is a proud partner with the National Center for Missing and Exploited Children. Photographs of missing children selected by the Center may appear in instructions on pages that would otherwise be blank. You can help bring these children home by looking at the photographs and calling **1-800-THE-LOST** (1-800-843-5678) if you recognize a child.

### Unresolved Tax Problems

Most problems can be resolved with one contact by calling, writing, or visiting an IRS office. But if the corporation has tried unsuccessfully to resolve a problem with the IRS, it should contact the Taxpayer Advocate's office. The corporation will be assigned a personal advocate who is in the best position to try to resolve the problem.

Contact the Taxpayer Advocate if the corporation:

- Is suffering or about to suffer a significant hardship.
- Is facing an immediate threat of adverse action.

- Will incur significant costs if relief is not granted (including fees for professional representation).
- Will suffer irreparable injury or long-term adverse impact if relief is not granted.
- Has experienced a delay of more than 30 calendar days to resolve a tax problem or inquiry.
- Has not received a response or resolution to the problem by the date promised.

The corporation may contact a Taxpayer Advocate by calling a toll-free assistance number **1-877-777-4778**. Persons who have access to TTY/TDD equipment may call 1-800-829-4059 and ask for the Taxpayer Advocate. If the corporation prefers, it may write to the Taxpayer Advocate at the IRS office that last contacted the corporation.

While Taxpayer Advocates cannot change the tax law or make a technical tax decision, they can clear up problems that resulted from previous contacts and ensure that the corporation's case is given a complete and impartial review. For more information about the Taxpayer Advocate, see **Pub. 1546**, The Taxpayer Advocate Service of the IRS.

### How To Get Forms and Publications

#### Personal computer

You can access the IRS's Internet Web Site 24 hours a day, 7 days a week at **www.irs.gov** to:

- Download forms, instructions, and publications.
- See answers to frequently asked tax questions.
- Search publications on-line by topic or keyword.
- Send us comments or request help by e-Mail.
- Sign up to receive local and national tax news by e-Mail.

You can also reach us using file transfer protocol at **ftp.irs.gov**.

#### CD-Rom

Order **Pub. 1796**, Federal Tax Products on CD-ROM, and get:

- Current year forms, instructions, and publications.

- Prior year forms, instructions, and publications.
- Popular tax forms that may be filled in electronically, printed out for submission, and saved for recordkeeping.
- The Internal Revenue Bulletin.

Buy the CD-ROM on the Internet at [www.irs.gov/cdorders](http://www.irs.gov/cdorders) from the National Technical Information Service (NTIS) for \$16 (plus a \$5 handling fee) and save 30%, or call **1-877-CDFORMS** (1-877-233-6767) toll free to buy the CD-ROM for \$23 (plus a \$5 handling fee).

### By phone and in person

You can order forms and publications 24 hours a day, 7 days a week, by calling **1-800-TAX-FORM (1-800-829-3676)**. You can also get most forms and publications at your local IRS office.

## General Instructions

### Purpose of Form

Use **Form 1120-PC**, U.S. Property and Casualty Insurance Company Income Tax Return, to report income, gains, losses, deductions, credits, and to figure the income tax liability of insurance companies, other than life insurance companies.

### Who Must File

Every domestic nonlife insurance company and every foreign corporation that would qualify as a nonlife insurance company subject to taxation under section 831, if it were a U.S. corporation, must file Form 1120-PC. This includes organizations described in section 501(m)(1) that provide commercial-type insurance and organizations described in section 833.

**Exceptions.** A nonlife insurance company that is:

- Exempt under section 501(c)(15) should file **Form 990**, Return of Organization Exempt from Income Tax.
- Subject to taxation under section 831, and disposes of its insurance business and reserves, or otherwise ceases to be taxed under section 831, but continues its corporate existence while winding up and liquidating its affairs, should file **Form 1120**, U.S. Corporation Income Tax Return.

**Life insurance companies.** Life insurance companies should file **Form 1120-L**, U.S. Life Insurance Company Income Tax Return.

### When To File

Generally, a corporation must file its income tax return by the 15th day of the 3rd month after its tax year ends. A new corporation filing a short period return must generally file by the 15th day of the

3rd month after the short period ends. A corporation that has dissolved must generally file by the 15th day of the 3rd month after the date it dissolved. A foreign corporation that does not maintain an office or place of business in the U.S. has until the 15th day of the 6th month after the end of its tax year to file.

If the due date falls on a Saturday, Sunday, or legal holiday, the corporation may file on the next business day.

**Private Delivery Services.** Corporations can use certain private delivery services designated by the IRS to meet the "timely mailing as timely filing/paying" rule for tax returns and payments. The most recent list of designated private delivery services was published by the IRS in August 1999. The list includes only the following:

- Airborne Express (Airborne): Overnight Air Express Service, Next Afternoon Service, Second Day Service.
- DHL Worldwide Express (DHL): DHL "Same Day" Service, DHL USA Overnight.
- Federal Express (FedEx): FedEx Priority Overnight, FedEx Standard Overnight, FedEx 2 Day.
- United Parcel Service (UPS): UPS Next Day Air, UPS Next Day Air Saver, UPS 2nd Day Air, UPS 2nd Day Air A.M.

The private delivery service can tell you how to get written proof of the mailing date.

**Extension.** File **Form 7004**, Application for Automatic Extension of Time To File Corporation Income Tax Return, to request a 6-month extension of time to file.

### Who Must Sign

The return must be signed and dated by:

- The president, vice-president, treasurer, assistant treasurer, chief accounting officer, or
- Any other corporate officer (such as tax officer) authorized to sign. Receivers, trustees, or assignees must sign and date any return filed on behalf of a corporation.

If a corporate officer prepared Form 1120-PC, the Paid Preparer's space should remain blank. Anyone who prepares Form 1120-PC but does not charge the corporation, should not sign the return. Generally, anyone who is paid to prepare the return must sign it and fill in the Paid Preparer's Use Only area.

The paid preparer must complete the required preparer information and:

- Sign it, by hand, in the space provided for the preparer's signature. (Signature stamps and labels are not acceptable.)
- Give a copy of the return to the taxpayer.

### Where To File

File your return at the applicable IRS address listed below.

If the corporation's principal business, office, or agency is located in	Use the following Internal Revenue Service Center address
Florida, Georgia, South Carolina	Atlanta, GA 39901
Kansas, New Mexico, Oklahoma, Texas	Austin, TX 73301
Indiana, Kentucky, Michigan, Ohio, West Virginia	Cincinnati, OH 45999
New Jersey, New York (New York City and counties of Nassau, Rockland, Suffolk, and Westchester)	Holtsville, NY 00501
New York (all other counties), Connecticut, Maine, Massachusetts, New Hampshire, Rhode Island, Vermont	Andover, MA 05501
Illinois, Iowa, Minnesota, Missouri, Wisconsin	Kansas City, MO 64999
Alabama, Arkansas, Louisiana, Mississippi, North Carolina, Tennessee	Memphis, TN 37501
Alaska, Arizona, California (counties of Alpine, Amador, Butte, Calaveras, Colusa, Contra Costa, Del Norte, El Dorado, Glenn, Humboldt, Lake, Lassen, Marin, Mendocino, Modoc, Napa, Nevada, Placer, Plumas, Sacramento, San Joaquin, Shasta, Sierra, Siskiyou, Solano, Sonoma, Sutter, Tehama, Trinity, Yolo, and Yuba), Colorado, Idaho, Montana, Nebraska, Nevada, North Dakota, Oregon, South Dakota, Utah, Washington, Wyoming	Ogden, UT 84201
California (all other counties), Hawaii	Fresno, CA 93888
Delaware, District of Columbia, Maryland, Pennsylvania, Virginia	Philadelphia, PA 19255

Corporations with their principal place of business outside the United States or claiming a possessions tax credit (sections 936 and 30A) must file with the Internal Revenue Service Center, Philadelphia, PA 19255.

A group of corporations located in several service center regions will often keep all the books and records at the principal office of the managing corporation. In this case, the income tax returns of the corporations may be filed with the service center for the region in which the principal office is located.

### Other Forms, Returns, and Statements That May Be Required

The corporation may have to file the following. See the applicable forms for more information.

#### Information Returns

The following is a list of information returns and what they are used to report. **Form 1098**, Mortgage Interest Statement: Report the receipt from any individual of \$600 or more of mortgage interest and

points in the course of the corporation's trade or business.

**Form 1099-A:** Report acquisitions and abandonments of secured property.

**Form 1099-B:** Report proceeds from broker and barter exchange transactions.

**Form 1099-C:** Report cancellation of a debt.

**Form 1099-DIV:** Report certain dividends and distributions.

**Form 1099-INT:** Report interest income.

**Form 1099-LTC:** Report certain payments made under a long-term care insurance contract and certain accelerated death benefits.

**Form 1099-MISC:** Report miscellaneous income (e.g., payments to certain fishing boat crew members; payments to providers of health and medical services; gross proceeds paid to attorneys; miscellaneous income payments and nonemployee compensation).

**Form 1099-MSA:** Report distributions from a medical savings account (MSA) or Medicare+Choice MSA.

**Form 1099-OID:** Report original issue discount.

**Form 1099-PATR:** Report distributions from cooperatives to their patrons.

**Form 1099-R:** Report distributions from retirement or profit-sharing plans, any individual retirement arrangement (IRA), or insurance contracts.

**Form 1099-S:** Report proceeds from real estate transactions.

**Form W-2, Wage and Tax Statement, and Form W-3, Transmittal of Wage and Tax Statements:** Are used to report withheld income, wages, tips, other compensation, social security, and Medicare taxes for an employee.

**Form 5498, IRA Contribution Information:** Report contributions (including rollover contributions) to any IRA, Roth conversions and the fair market value of the account.

**5498-MSA, MSA or Medicare+Choice MSA Information:** Report contributions to a medical savings account (MSA) and the value of an MSA or Medicare+Choice MSA.

**Form 8281, Information Return for Publicly Offered Original Issue Discount Instruments:** Report the issuance of public offerings of debt instruments.

**Form 8300, Report of Cash Payments Over \$10,000 Received in a Trade or Business:** Report the receipt of more than \$10,000 in cash or foreign currency in one transaction or a series of related transactions.

**Note:** To transmit Forms 1098, 1099, and 5498, get **Form 1096, Annual Summary and Transmittal of U.S. Information Returns.**

## Employment Tax Returns

**Form 940 or Form 940-EZ, Employer's Annual Federal Unemployment (FUTA) Tax Return,** is filed to report annual Federal unemployment (FUTA) tax if either of the following requirements are

met: **(1)** The corporation paid wages of \$1,500 or more in any calendar quarter in 1998 or 1999, or **(2)** The corporation had at least one employee who worked for the corporation for some part of a day in any 20 or more different weeks in 1998 or 20 or more different weeks in 1999.

**Form 941, Employer's Quarterly Federal Tax Return,** is filed to report payroll income tax withheld and employer and employee social security and Medicare taxes. (Also, see **Trust fund recovery penalty** on page 5.)

**Form 945, Annual Return of Withheld Federal Income Tax,** is filed to report income tax withholding from nonpayroll distributions (e.g., pensions, annuities, IRAs, military retirement, gambling winnings, Indian gaming profits, and backup withholding). (Also, see **Trust fund recovery penalty** on page 5.)

## International Forms

**Form 926, Return by a U.S. Transferor of Property to a Foreign Corporation,** is required to report certain transfers to foreign corporations under section 6038B.

**Form 1042, Annual Withholding Tax Return for U.S. Source Income of Foreign Persons, and Form 1042-S, Foreign Person's U.S. Source Income Subject to Withholding,** are used to report and send withheld tax on payments or distributions made to nonresident alien individuals, foreign partnerships, or foreign corporations. Also, see sections 1441 and 1442, and **Pub. 515, Withholding of Tax on Nonresident Aliens and Foreign Corporations.**

**Form 5471, Information Return of U.S. Persons With Respect to Certain Foreign Corporations,** is required if the corporation:

- controls a foreign corporation;
- acquires, disposes of, or owns 10% or more in value or vote of the outstanding stock of a foreign corporation;
- or, had control of a foreign corporation for an uninterrupted period of at least 30 days during the annual accounting period of the foreign corporation.

**Form 5472, Information Return of a 25% Foreign-Owned U.S. Corporation or a Foreign Corporation Engaged in a U.S. Trade or Business,** is filed if the corporation is 25% or more foreign-owned. See the instructions for Question 6 on page 17.

**Form 5713, International Boycott Report,** must be filed if the corporation has operations in, or related to, certain "boycotting" countries.

**Form 8865, Return of U.S. Persons With Respect To Certain Foreign Partnerships.** A corporation that contributed property after August 5, 1997 to a foreign partnership in exchange for a partnership interest may have to file this form if: **(a)** immediately after the contribution, the corporation owned, directly or indirectly, at least a 10% interest in the foreign partnership, **or (b)** the fair market value of the property the corporation contributed

to the foreign partnership in exchange for a partnership interest, when added to other contributions of property made to the partnership during the preceding 12-month period, exceeds \$100,000. Also, the corporation may have to file Form 8865 to report certain dispositions by a foreign partnership of property it previously contributed to that partnership if it was a partner at the time of the disposition. For more details, including penalties that may apply, see Form 8865 and its separate instructions.

## Other Forms

**Form 720, Quarterly Federal Excise Tax Return.** Use Form 720 to report and pay:

- The luxury tax on passenger vehicles,
- Environmental taxes,
- Communications and air transportation taxes,
- Fuel taxes,
- Manufacturers taxes,
- Ship passenger taxes,
- Certain other excise taxes.

**Form 966, Corporate Dissolution or Liquidation,** is used to report the adoption of a resolution or plan to dissolve the corporation or liquidate any of its stock.

**Form 5452, Corporate Report of Nondividend Distributions,** is used to report nondividend distributions.

**Form 8264, Application for Registration of a Tax Shelter,** is used to apply for a tax shelter registration number (used by tax shelter organizers).

**Form 8271, Investor Reporting of Tax Shelter Registration Number.** Report a registered tax shelter's registration number. This form must be filed with any return on which a deduction, loss, credit, or other tax benefit is claimed or reported (or any income is reported) from an interest in a tax shelter. The requirement applies to all returns, including applications for tentative refund (Form 1139) and amended returns (Form 1120X).

**Form 8275, Disclosure Statement, and Form 8275-R Regulation Disclosure Statement,** are used to disclose (to avoid parts of the accuracy-related penalty or certain preparer penalties) items or positions taken on a tax return that are not otherwise adequately disclosed on the tax return or that are contrary to Treasury Regulations.

**Form 8594, Asset Acquisition Statement,** is used to report the purchase or sale of a group of assets that constitute a trade or business if goodwill or going concern value attach to the assets.

**Form 8816, Special Loss Discount Account and Special Estimated Tax Payments for Insurance Companies.** This form must be filed by any insurance company that elects to take an additional deduction under section 847.

**Form 8842, Election to Use Different Annualization Periods for Corporate Estimated Tax,** is filed to elect one of the annualization periods in section 6655(e)(2)(C) to figure estimated tax

payments under the annualized income installment method.

**Form 8849**, Claim for Refund of Excise Taxes, is used to claim a refund of excise taxes reported on Form 720, 730, 11-C, or 2290.

### Consolidated Return

If an affiliated group of corporations includes one or more domestic life insurance companies taxed under section 801, the common parent may elect to treat those companies as includible corporations. The life insurance companies must have been members of the group for the 5 tax years immediately preceding the tax year for which the election is made. See section 1504(c)(2) and Regulations section 1.1502-47(d)(12).

The parent corporation of an affiliated group of corporations must attach **Form 851**, Affiliations Schedule, to the consolidated return. For the first year a consolidated return is filed, each subsidiary must attach **Form 1122**, Authorization and Consent of Subsidiary Corporation to be Included in a Consolidated Income Tax Return.

File supporting statements for each corporation included in the consolidated return. Use columns to show the following, both before and after adjustments:

- Items of gross income and deductions.
- A computation of taxable income.
- Balance sheets as of the beginning and end of the tax year.
- A reconciliation of income per books with income per return.
- A reconciliation of retained earnings.

Enter the totals for the consolidated group on Form 1120-PC. Attach consolidated balance sheets and a reconciliation of consolidated retained earnings.

For more information on consolidated returns, see the regulations under section 1502.

**Note:** *If a nonlife insurance company is a member of an affiliated group, file Form 1120-PC as an attachment to the consolidated return in lieu of filing supporting statements. Write across the top of page 1 of Form 1120-PC, "Supporting Statement to Consolidated Return."*

### Statements

**NAIC annual statement.** Regulations section 1.6012-2(c) requires that the NAIC annual statement be filed with Form 1120-PC. A penalty for the late filing of a return may be imposed for not including the annual statement when the return is filed.

**Stock ownership in foreign corporations.** Attach the statement required by section 551(c) if the corporation:

- Owned 5% or more in value of the outstanding stock of a foreign personal holding company and

- Was required to include in its gross income any undistributed foreign personal holding company income from a foreign personal holding company.

**Transfers to a corporation controlled by the transferor.** If a person receives stock of a corporation in exchange for property, and no gain or loss is recognized under section 351, the person (transferor) and the transferee must each attach to their tax returns the information required by Regulations section 1.351-3.

### Attachments

Attach **Form 4136**, Credit for Federal Tax Paid on Fuels, after page 8, Form 1120-PC. Attach schedules in alphabetical order and other forms in numerical order after Form 4136.

Complete every applicable entry space on Form 1120-PC. Do not write "See attached" instead of completing the entry spaces. If you need more space on the forms or schedules, attach separate sheets. Use the same size and format as on the printed forms.

Show the corporation's totals on the printed forms. Attach these separate sheets after all the schedules and forms. Be sure to put the corporation's name and EIN on each sheet.

### Accounting Methods

Figure taxable income using the method of accounting regularly used in keeping the corporation's books and records. Generally, permissible methods include:

- Cash,
- Accrual, or
- Any other method authorized by the Internal Revenue Code.

The gross amounts of underwriting and investment income should be computed on the basis of the underwriting and investment exhibit of the NAIC annual statement. In all cases, the method used must clearly show taxable income.

Generally, a corporation must use the accrual method of accounting if its average annual gross receipts exceed \$5 million. See section 448(c).

Under the accrual method, an amount is includible in income when:

- All the events have occurred that fix the right to receive the income, and
- The amount can be determined with reasonable accuracy.

See Regulations section 1.451-1(a) for details.

Generally, an accrual basis taxpayer can deduct accrued expenses in the tax year in which:

- All events that determine the liability have occurred,
- The amount of the liability can be figured with reasonable accuracy, and
- Economic performance takes place with respect to the expense.

There are exceptions to the economic performance rule for certain items, including recurring expenses. See section 461(h) and the related regulations for the

rules for determining when economic performance takes place.

### Change in Accounting Method

Generally, the corporation may change the method of accounting used to report taxable income (for income as a whole or for any material item) only by getting consent on **Form 3115**, Application for Change in Accounting Method. For more information, see **Pub. 538**, Accounting Periods and Methods.

### Rounding Off to Whole Dollars

The corporation may show amounts on the return and accompanying schedules as whole dollars. To do so, drop any amount less than 50 cents and increase any amount from 50 cents through 99 cents to the next higher dollar.

### Recordkeeping

Keep the corporation's records for as long as they may be needed for the administration of any provision of the Internal Revenue Code. Usually, records that support an item of income, deduction, or credit on the return must be kept for 3 years from the date the return is due or filed, whichever is later. Keep records that verify the corporation's basis in property for as long as they are needed to figure the basis of the original or replacement property.

The corporation should also keep copies of all filed returns. They help in preparing future returns and amended returns.

### Depository Method of Tax Payment

The corporation must pay the tax due in full no later than the 15th day of the 3rd month after the end of the tax year. The two methods of depositing corporate income taxes are discussed below.

**Electronic deposit requirement.** The corporation must make electronic deposits of **all** depository tax liabilities that occur after 1999 if it deposited, in 1998, more than \$200,000 in **all** Federal depository taxes (such as employment tax, excise tax, or corporate income tax). If the corporation is already depositing electronically but its deposits did not exceed \$200,000, the corporation may continue to do so voluntarily, or it may make deposits with **Form 8109**, Federal Tax Deposit Coupon. Corporations that exceed the new \$200,000 threshold must continue to deposit electronically in all later years.

The Electronic Federal Tax Payment System (EFTPS) must be used to make electronic deposits. If the corporation is required to make electronic deposits and fails to do so, it may be subject to a 10% penalty.

A corporation that is not required to make electronic deposits may voluntarily participate in EFTPS. To enroll in EFTPS,

call 1-800-555-4477 or 1-800-945-8400. For general information about EFTPS, call 1-800-829-1040.

**Deposits with Form 8109.** If the corporation does not use EFTPS, deposit corporation income tax payments (and estimated tax payments) with Form 8109. Do not send deposits directly to an IRS office. Mail or deliver the completed Form 8109 with the payment to a qualified depository for Federal taxes or to the Federal Reserve bank (FRB) servicing the corporation's geographic area. Make checks or money orders payable to that depository or FRB. To help ensure proper crediting, write the corporation's employer identification number, the tax period to which the deposit applies, and "Form 1120-PC" on the check or money order. Be sure to darken the "1120" box on the coupon. Records of these deposits will be sent to the IRS.

A penalty may be imposed if the deposits are mailed or delivered to an IRS office rather than to an authorized depository or FRB. For more information on deposits, see the instructions in the coupon booklet (Form 8109) and **Pub. 583, Starting a Business and Keeping Records.**

 **If the corporation owes tax when it files Form 1120-PC, do not include the payment with the tax return. Instead, mail or deliver the payment with Form 8109 to a qualified depository or FRB, or use EFTPS, if applicable.**

## Estimated Tax Payments

Generally, the following rules apply to the corporation's payments of estimated tax.

The corporation must make installment payments of estimated tax if it expects its estimated tax (income tax minus credits) to be \$500 or more.

The installments are due by the 15th day of the 4th, 6th, 9th, and 12th months of the tax year. If any date falls on a Saturday, Sunday, or legal holiday, the installment is due on the next regular business day.

Use **Form 1120-W, Estimated Tax for Corporations**, as a worksheet to compute estimated tax. If the corporation does not use EFTPS, use the deposit coupons (Form 8109) to make deposits of estimated tax.

For information on estimated tax payments, including penalties that apply if the corporation fails to make required payments, see the instructions for line 17 on page 8.

## Overpaid Estimated Tax

If the corporation overpaid estimated tax, it may be able to get a quick refund by filing **Form 4466, Corporation Application for Quick Refund of Overpayment of Estimated Tax**. The overpayment must be at least 10% of expected income tax liability and at least \$500. To apply for a

quick refund, file Form 4466 before the 16th day of the 3rd month after the end of the tax year, but before the corporation files its income tax return. Do not file Form 4466 before the end of the corporation's tax year.



**Foreign insurance companies, see Notice 90-13, 1990-1 C.B. 321, before computing estimated tax.**

## Interest and Penalties

**Interest.** Interest is charged on taxes paid late even if an extension of time to file is granted. Interest is also charged on penalties imposed for failure to file, negligence, fraud, gross valuation overstatements, and substantial understatements of tax from the due date (including extensions) to the date of payment. The interest charge is figured at a rate determined under section 6621.

**Penalty for late filing of return.** A corporation that does not file its tax return by the due date, including extensions, may be penalized 5% of the unpaid tax for each month or part of a month the return is late, up to a maximum of 25% of the unpaid tax. The minimum penalty for a return that is over 60 days late is the smaller of the tax due or \$100. The penalty will not be imposed if the corporation can show that the failure to file on time was due to reasonable cause. Corporations that file late must attach a statement explaining the reasonable cause.

**Penalty for late payment of tax.** A corporation that does not pay the tax when due generally may be penalized 1/2 of 1% of the unpaid tax for each month or part of a month the tax is not paid, up to a maximum of 25% of the unpaid tax. The penalty will not be imposed if the corporation can show that the failure to pay on time was due to reasonable cause.

**Trust fund recovery penalty.** This penalty may apply if certain excise, income, social security, and Medicare taxes that must be collected or withheld are not collected or withheld, or these taxes are not paid to IRS. These taxes are generally reported on Forms 720, 941, 943, or 945, (see **Other Forms, Returns, and Statements That May Be Required**, on page 2). The trust fund recovery penalty may be imposed on all persons who are determined by the IRS to have been responsible for collecting, accounting for, and paying over these taxes, and who acted willfully in not doing so. The penalty is equal to the unpaid trust fund tax. See the instructions for Form 720 or **Pub. 15 (Circular E)**, Employer's Tax Guide, for details, including the definition of responsible persons.

**Other penalties.** Other penalties can be imposed for negligence, substantial understatement of tax, and fraud. See sections 6662 and 6663.

## Specific Instructions

### Period Covered

File the 1999 return for calendar year 1999.

### Address and Employer Identification Number

#### Address

Include the suite, room, or other unit number after the street address.

If the Post Office does not deliver mail to the street address and the corporation has a P.O. box, show the box number instead.

**Note:** If a change of address occurs after the return is filed, use **Form 8822, Change of Address**, to notify the IRS of the new address.

#### Employer identification number (EIN).

Show the correct EIN in Item B on page 1 of Form 1120-PC. If the corporation does not have an EIN, it should apply for one on **Form SS-4, Application for Employer Identification Number**. Form SS-4 can be obtained at Social Security Administration (SSA) offices or by calling 1-800-TAX-FORM. If the corporation has not received its EIN by the time the return is due, write "Applied for" in the space provided for the EIN. See Pub. 583 for more information.

### Item A. Section 953 Election

Check the applicable box if the corporation is a foreign corporation and elects under:

1. Section 953(c)(3)(C) to treat its related person insurance income as effectively connected with the conduct of a trade or business in the U.S., or
2. Section 953(d) to be treated as a domestic corporation.

Generally, a foreign corporation making either election must file its return with the Internal Revenue Service Center, Philadelphia, PA 19255. See Notice 87-50, 1987-2 C.B. 357, and Notice 89-79, 1989-2 C.B. 392, for the procedural rules election statement formats, and filing addresses for making the respective elections under section 953(c)(3)(C) or section 953(d).

**Note:** Once either election is made, it will apply to the tax year for which made and all subsequent tax years unless revoked with the consent of the Secretary. Also, any loss of a foreign corporation electing to be treated as a domestic insurance company under section 953(d), will be treated as a dual consolidated loss and may not be used to reduce the taxable income of any other member of the affiliated group for this tax year or any other tax year.

**Item E. Final Return, Change of Address, or Amended Return**

Indicate a final return, change of address, or amended return by checking the appropriate box.

**Taxable Income**

**Line 1, Taxable income, and line 2, Taxable investment income.** If the corporation is a small company as defined in section 831(b)(2) and elects under section 831(b)(2)(A)(ii) to be taxed on taxable investment income, complete Schedule B (ignore Schedule A) and enter the amount from Schedule B, line 21, on line 2, page 1. All other corporations should complete Schedule A (ignore Schedule B) and enter on line 1, page 1, the amount from Schedule A, line 37.

**Tax Computation and Payments**

**Note:** *Members of a controlled group must attach a statement showing the computation of the tax entered on line 4.*

**Tax Computation Worksheet for Members of a Controlled Group**  
(Keep for your records.)

**Note:** *Each member of a controlled group must compute the tax using this worksheet.*

1. Enter taxable income (line 1 or line 2, page 1) .....
2. Enter line 1 or the corporation's share of the \$50,000 taxable income bracket, whichever is less .....
3. Subtract line 2 from line 1 .....
4. Enter line 3 or the corporation's share of the \$25,000 taxable income bracket, whichever is less .....
5. Subtract line 4 from line 3 .....
6. Enter line 5 or the corporation's share of the \$9,925,000 taxable income bracket, whichever is less .....
7. Subtract line 6 from line 5 .....
8. Multiply line 2 by 15% .....
9. Multiply line 4 by 25% .....
10. Multiply line 6 by 34% .....
11. Multiply line 7 by 35% .....
12. If the taxable income of the controlled group exceeds \$100,000, enter this member's share of the smaller of: 5% of the taxable income in excess of \$100,000, or \$11,750. See the instructions for line 3b below.....
13. If the taxable income of the controlled group exceeds \$15 million, enter this member's share of the smaller of : 3% of the taxable income in excess of \$15 million, or \$100,000. See the instructions for line 3b below.....
14. **Total.** Add lines 8 through 13. Enter here and on line 4, page 1.....

**Line 3**

**Members of a controlled group.** A member of a controlled group, as defined in section 1563, must check the box on line 3 and complete lines 3a and 3b on page 1.

**Line 3a.** Members of a controlled group are entitled to one \$50,000, one \$25,000, and one \$9,925,000 taxable income bracket amount (in that order) on line 3a.

When a controlled group adopts or later amends an apportionment plan, each member must attach to its tax return a copy of its consent to this plan. The copy (or an attached statement) must show the part of the amount in each taxable income bracket apportioned to that member. See Regulations section 1.1561-3(b) for other requirements and for the time and manner of making the consent.

**Unequal apportionment plan.** Members of a controlled group may elect an unequal apportionment plan and divide the taxable income brackets as they want. There is no need for consistency among taxable income brackets. Any member may be entitled to all, some, or none of the taxable income bracket. However, the total amount for all members cannot be more than the total amount in each taxable income bracket.

**Equal apportionment plan.** If no apportionment plan is adopted, members of a controlled group must divide the amount in each taxable income bracket equally among themselves. For example, controlled group AB consists of Corporation A and Corporation B. They do not elect an apportionment plan.

Therefore, each corporation is entitled to:  
 • \$25,000 (one-half of \$50,000) on line 3a(1),  
 • \$12,500 (one-half of \$25,000) on line 3a(2), and  
 • \$4,962,500 (one-half of \$9,925,000) on line 3a(3).

**Line 3b.** Members of a controlled group are treated as one group to figure the applicability of the additional 5% tax and the additional 3% tax. If an additional tax applies, each member will pay that tax based on the part of the amount used in each taxable income bracket to reduce that member's tax. See section 1561(a). If an additional tax applies, attach a schedule showing the taxable income of the entire group and how the corporation figured its share of the additional tax.

**Line 3b(1)**

Enter the corporation's share of the additional 5% tax on line 3b(1).

**Line 3b(2)**

Enter the corporation's share of the additional 3% tax on line 3b(2).

**Line 4**

Most corporations figure their tax by using the Tax Rate Schedule below. Exceptions apply to members of a controlled group. See the instructions below the Tax Rate Schedule and the worksheet above for more information.

**Tax Rate Schedule**

If the amount on line 1 or line 2, page 1, Form 1120-PC is:

Over—	But not over—	Tax is:	Of the amount over—
\$0	\$50,000	15%	\$0
50,000	75,000	\$ 7,500 + 25%	50,000
75,000	100,000	13,750 + 34%	75,000
100,000	335,000	22,250 + 39%	100,000
335,000	10,000,000	113,900 + 34%	335,000
10,000,000	15,000,000	3,400,000 + 35%	10,000,000
15,000,000	18,333,333	5,150,000 + 38%	15,000,000
18,333,333	- - - -	35%	0

**Deferred tax under section 1291.** If the corporation was a shareholder in a passive foreign investment company (PFIC), and the corporation received an excess distribution or disposed of its investment in the PFIC during the year, it must include the total increase in taxes due under section 1291(c)(2) in the amount entered on line 4. On the dotted line next to line 4, write "Section 1291" and the amount.

Do not include on line 4 any interest due under section 1291(c)(3). Instead, write the amount of interest owed in the bottom margin of page 1 and label it "Section 1291 interest." For details, see **Form 8621**, Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund.

**Additional tax under section 197(f).** A corporation that elects to pay tax on the gain from the sale of an intangible under the related person exception to the anti-churning rules should include any additional tax due under section 197(f)(9)(B) in the amount entered on line 4. On the dotted line next to line 4, write "Section 197" and the amount. For more information, see **Pub. 535**, Business Expenses.

**Line 5. Enter amount of tax that a reciprocal must include.** A mutual insurance company which is an interinsurer or reciprocal underwriter may elect, under section 835, to limit the deduction for amounts paid or incurred to a qualifying attorney-in-fact to the amount of the deductions of the attorney-in-fact allocable to the income received by the attorney-in-fact from the reciprocal. If this election is made, any increase in taxable income of a reciprocal as a result of this limitation is taxed at the highest rate of tax specified in section 11(b).

Make no entry on line 5 if the mutual insurance company's taxable income before including the section 835(b) amount is \$100,000 or more. Otherwise, this tax is 35% of the section 835(b) amount. If an entry is made on line 5, attach a statement showing how the tax was computed.

Reciprocal underwriters making the section 835(a) election are allowed a credit on line 16h for the amount of tax paid by the attorney-in-fact that is related to the income received by the

attorney-in-fact from the reciprocal in the tax year.

See section 835 and the related regulations for special rules and information regarding the statements required to be attached to the return.

**Line 7a. Foreign tax credit.** To find out when a corporation can take this credit for payment of income tax to a foreign country or U.S. possession, see **Form 1118**, Foreign Tax Credit—Corporations.

**Line 7b. Other credits.**

**Possessions tax credit.** The Small Business Job Protection Act of 1996 repealed the possessions credit. However, existing credit claimants may qualify for a credit under the transitional rules. Get **Form 5735**, Possessions Tax Credit (Under Sections 936 and 30A).

Include the credit in the amount shown on line 7b. On the line to the left of the entry space, write the amount of the credit and identify it as a section 936 credit.

**Nonconventional source fuel credit.** A credit is allowed for the sale of qualified fuels produced from a nonconventional source. Section 29 contains a definition of qualified fuels, provisions for figuring the credit, and other special rules. Attach a separate schedule to the return showing the computation of the credit.

**Qualified electric vehicle (QEV) credit.** Include on line 7b any credit from **Form 8834**, Qualified Electric Vehicle Credit. Vehicles that qualify for this credit are not eligible for the deduction for clean-fuel vehicles under section 179A.

**Line 7c. General business credit.**

Complete this line if the corporation can take any of the following credits. Complete **Form 3800**, General Business Credit, if the corporation has two or more of these credits, (other than the empowerment zone employment credit), general credits from an electing large partnership, a general business credit carryforward or carryback (other than the empowerment zone employment credit), a trans-Alaska pipeline liability fund credit, or a passive activity credit (other than the low-income housing credit or the empowerment zone employment credit). Enter the amount of the general business credit on line 7c, and check the box for **Form 3800**.

If the corporation has only one credit, enter on line 7c the amount of the credit from the form. Also be sure to check the appropriate box for that form.

**Form 3468**, Investment Credit.

**Form 5884**, Work Opportunity Credit.

**Form 6478**, Credit for Alcohol Used as Fuel.

**Form 6765**, Credit for Increasing Research Activities.

**Form 8586**, Low-Income Housing Credit.

**Form 8820**, Orphan Drug Credit.

**Form 8826**, Disabled Access Credit.

**Form 8830**, Enhanced Oil Recovery Credit.

**Form 8835**, Renewable Electricity Production Credit.

**Form 8844**, Empowerment Zone Employment Credit.

**Note:** *Although the empowerment zone employment credit is a component of the general business credit, it is figured separately and is not carried to Form 3800.*

**Form 8845**, Indian Employment Credit.

**Form 8846**, Credit for Employer Social Security and Medicare Taxes Paid on Certain Employee Tips.

**Form 8847**, Credit for Contributions to Selected Community Development Corporations.

**Form 8861**, Welfare-to-Work Credit.

**Line 7d. Credit for prior year minimum tax.** To figure the minimum tax credit and any carryforward of that credit, use **Form 8827**, Credit for Prior Year Minimum Tax—Corporations.

Also see **Form 8827** if any of the corporation's 1998 nonconventional source fuel credit, or qualified electric vehicle credit was disallowed solely because of the tentative minimum tax limitation. See section 53(d).

**Line 9. Foreign corporations.** A foreign corporation carrying on an insurance business in the United States is taxed as a domestic insurance company on its income effectively connected with the conduct of a trade or business in the United States. See sections 842 and 897, and Notice 89-96, 1989-2 C.B. 417, for more information. See Rev. Proc. 998-30, 1999-31 I.R.B. 221 for the domestic asset/liability percentages and domestic investment yields needed by foreign insurance companies to compute their minimum effectively connected net investment income under section 842(b). Income from sources outside the United States from U.S. business is treated as effectively connected with the conduct of a trade or business in the United States. For a definition of effectively connected income, see sections 864(c) and 897.

Generally, under section 881, any other U.S. source income received by a foreign corporation that is not effectively connected with the conduct of a trade or business in the United States is taxed at 30% (or at a lower treaty rate). If the corporation has this income, attach a schedule showing the kind and amount of income, the tax rate, and the amount of tax.

**Note:** *Interest received from certain portfolio debt investments that were issued after July 18, 1984, is not subject to the tax.*

Additional taxes resulting from the net investment income adjustment may offset a corporation's 30% tax on U.S. source income. The tax reduction is determined by multiplying the 30% tax by the ratio of the amount of income adjustment to income subject to the 30% tax, computed without the exclusion for interest on state and local bonds or income exempted from taxation by treaty. See section 842(c)(2).

Attach a statement showing how the reduction under section 881 was figured. Include the net tax imposed by section 881 on line 9.

**Note:** *Section 953(d) allows a foreign insurance company to elect to be taxed as a domestic corporation. If elected, include the additional tax required to be paid on line 15. Write on the dotted line to the left of line 15, "Sec. 953(d) tax" and the amount. Attach a schedule showing the computation. See section 953(d) for more details.*

**Line 10. Personal holding company tax.** A corporation is taxed as a personal holding company (PHC) under section 542 if:

- At least 60% of its adjusted ordinary gross income for the tax year is PHC income, and
- At any time during the last half of the tax year more than 50% in value of its outstanding stock is owned, directly or indirectly, by five or fewer individuals.

To figure this tax, use **Schedule PH (Form 1120)**, U.S. Personal Holding Company Tax.

**Line 11. Recapture taxes**

**Recapture of investment credit.** If the corporation disposed of investment credit property or changed its use before the end of its useful life or recovery period, it may owe a tax. See **Form 4255**, Recapture of Investment Credit, for details.

**Recapture of low-income housing credit.** If the corporation disposed of property (or there was a reduction in the qualified basis of the property) for which it took the low-income housing credit, it may owe a tax. See **Form 8611**, Recapture of Low-Income Housing Credit.

**Recapture of qualified electric vehicle (QEV) credit.** The corporation must recapture part of the QEV credit it claimed in a prior year if, within 3 years of the date the vehicle was placed in service, it ceases to qualify for the credit. See Regulations section 1.30-1 for details on how to figure the recapture. Include the amount of the recapture in the total for line 11, page 1, **Form 1120-PC**. On the dotted line next to the entry space, write "QEV" and the amount.

**Recapture of Indian employment credit.** Generally, if an employer terminates the employment of a qualified employee less than 1 year after the date of initial employment, any Indian employment credit allowed for a prior tax year by reason of wages paid or incurred to that employee must be recaptured. For details, see **Form 8845**, and section 45A. Include the amount of the recapture in the total for line 11, page 1. On the dotted line next to the entry space, write "45" and the amount.

**Line 12. Alternative minimum tax.** Unless the corporation is treated as a small corporation exempt from the alternative minimum tax (AMT), it may owe the AMT if it has any of the adjustments and tax preference items

listed on **Form 4626**, Alternative Minimum Tax—Corporations. The corporation must file Form 4626 if its taxable income (loss) combined with these adjustments and tax preference items is more than the smaller of:

- \$40,000, or
- The corporation's allowable exemption amount (from Form 4626).

For this purpose, taxable income does not include the NOL deduction. Get Form 4626 for details.

Reduce the AMT by any amounts from Form 3800, Schedule A, line 37, and from Form 8844, line 25. On the dotted line next to line 12, write "Section 38(c)(2)" ("EZE" if from Form 8844) and the amounts.

**Small corporation exemption.** A corporation is treated as a small corporation exempt from the AMT for its tax year beginning in 1999 if that year is the corporation's first tax year in existence or:

1. It was treated as a small corporation exempt from the AMT for prior tax years beginning after 1997, and
2. its average annual gross receipts for the 3-tax-year-period ending before its tax year beginning in 1999 did not exceed \$7.5 million (\$5 million if that period is the corporation's first 3-tax year period in existence).

For more details, see the instructions for Form 4626.

**Line 14. Qualified Zone Academy Bond Credit.** Enter the amount of any credit from Form 8860, Qualified Zone Academy Bond Credit.

#### Line 15. Total tax

Other tax and interest amounts may be included in or subtracted from the total tax reported on line 15.

**Amounts to include** in the total for line 15:

- Interest on deferred tax attributable to certain nondealer installment obligations (section 453A(c))
- For shareholders in qualified electing funds, deferred tax due upon termination of a section 1294 election (see Form 8621, Part V)

**Amount to subtract** from the total for line 15:

- Deferred tax on the corporation's share of the undistributed earnings of a qualified electing fund (see Form 8621, Part II)

**How to Report.** Attach a schedule showing your computation of each item included in, or subtracted from, the total for line 15. On the dotted line next to line 15, enter the amount of tax or interest and:

- Identify it as tax or interest
- Specify the code section that applies.

If you figure the tax or interest using another form (e.g., Form 8621), see the instructions for that form to find out how to report the amount and what to write on line 15.

#### Line 16b. Prior year(s) special estimated tax payments to be applied.

The amount entered on line 16b must agree with the amount(s) from line 10, Part II, Form 8816. See Form 8816 and section 847(2) for additional information.

#### Line 16c. Estimated tax payments.

Enter any estimated tax payments the corporation made for the tax year. Do not include any amount being applied on line 16d as a "Special estimated tax payment."

**Line 16d. Special estimated tax payments.** If the deduction under section 847 is claimed on Schedule A, line 27, special estimated tax payments must be made in an amount equal to the tax benefit of the deduction. These payments must be made on or before the due date (without regard to extensions) of this tax return. See Form 8816 and section 847(2) for additional information.

**Line 16h. Credit by reciprocal for tax paid by attorney-in-fact under section 835(d).** Enter the amount of tax paid by an attorney-in-fact as a result of income received by the attorney-in-fact from the reciprocal during the tax year. For more information, see section 835, the related regulations, and the instructions for line 5 on page 6.

**Line 16i. Other credits and payments.** Enter the amount of any other credits the corporation may take and/or payments made. Write to the left of the entry space, an explanation of the entry.

**Backup withholding.** If the corporation had income tax withheld from any payments it received, because, for example, it failed to give the payer its correct EIN, include the amount withheld in the total for line 16i. This type of withholding is called backup withholding. Show the amount withheld in the blank space in the right hand column between lines 15 and 16j, and write "backup withholding."

**Line 16j. Total payments.** Add the amounts on lines 16f through 16i and enter the total on line 16j.

**Line 17. Estimated tax penalty.** A corporation that does not make estimated tax payments when due may be subject to an underpayment penalty for the period of underpayment. Generally, a corporation is subject to the penalty if its tax liability is \$500 or more, and it did not timely pay the smaller of:

- 100% of its tax liability for 1999, or
- 100% of its prior year's tax. See section 6655 for details and exceptions, including special rules for large corporations.

Use **Form 2220**, Underpayment of Estimated Tax by Corporations, to see if the corporation owes a penalty and to figure the amount of the penalty. Generally, the corporation does not have to file this form because the IRS can figure the amount of any penalty and bill the corporation for it. However, even if the corporation does not owe the penalty, you must complete and attach Form 2220 if either of the following apply:

- The annualized income or adjusted seasonal installment method is used.
- The corporation is a large corporation computing its first required installment based on the prior year's tax. (See the Form 2220 instructions for the definition of a large corporation.)

If you attach Form 2220, be sure to check the box on line 17, and enter the amount of any penalty on that line.

## Schedule A — Taxable Income

**Gross income.** The gross amounts of underwriting and investment income should be computed on the basis of the underwriting and investment exhibit of the NAIC annual statement.

**Note:** *In computing the amounts for lines 2, 3, and 4, take all interest, dividends, or rents received during the year, add interest, dividends, or rents due and accrued at the end of the tax year, and deduct interest, dividends, or rents due and accrued at the end of the preceding tax year. For rules regarding the accrual of dividends, see Regulations section 1.301-1(b).*

#### Line 3a, column (a). Gross interest.

Enter the gross amount of interest income, including all tax-exempt interest.

**Line 3b, column (a).** Section 103(a) excludes interest on state or local bonds from gross income.

This exclusion does not apply to any:

1. Private activity bond which is not a qualified bond as defined by section 141;
2. Arbitrage bond as defined by section 148; or
3. Bonds not meeting the requirements of section 149 (regarding the registration of tax-exempt bonds).

#### Lines 3a and 3b, column (b).

**Amortization of premium.** Enter on line 3a, column (b), the total amortization of bond premium, including amortization on tax-exempt bonds. Enter on line 3b, column (b), the amortization of bond premium on tax-exempt bonds only.

**Note:** *Insurance companies electing to amortize discount for tax purposes must reduce the amortization of premium by any amortization of discount.*

**Line 4. Gross rents.** Enter gross rents, computed as indicated under the instructions for **Gross income** above. Deduct rental expenses, such as repairs, interest, taxes, and depreciation on the proper lines for deductions section.

**Line 6. Capital gain net income.** Every sale or exchange of a capital asset by a corporation must be reported in detail on **Schedule D (Form 1120)**, Capital Gains and Losses, even though no gain or loss is indicated.

Generally, losses from sales or exchanges of capital assets are only allowed to the extent of gains. However, corporations taxed under section 831 may claim losses from capital assets sold or exchanged to get funds to meet abnormal

insurance losses and to pay dividends and similar distributions to policyholders. **DO NOT** include those types of losses here, but instead, report them on Schedule G.

The net capital loss for these corporations is the amount by which losses for the year from sales or exchanges of capital assets exceed the gains from these sales or exchanges plus the smaller of:

1. Taxable income (computed without gains or losses from sales or exchanges of capital assets); or

2. Losses from the sale or exchange of capital assets sold or exchanged to obtain funds to meet abnormal insurance losses and to provide for the payment of dividends and similar distributions to policyholders.

Subject to the limitations in section 1212(a), a net capital loss can be carried back 3 years and forward 5 years as a short-term capital loss.

**Line 8. Certain mutual fire or flood insurance companies.** A mutual fire or flood insurance company whose principal business is the issuance of policies:

1. For which the premium deposits are the same (regardless of the length of the term the policies are written for), and

2. Under which the unabsorbed portion of such premium deposits not required for losses, expenses, or establishment of reserves is returned or credited to the policyholder on cancellation or expiration of the policy, must include in income an amount equal to 2% of the premiums earned on insurance contracts during the tax year with respect to such policies after deduction of premium deposits returned or credited during the same tax year. See section 832(b)(1)(D).

**Line 9. Income on account of the special income and deduction accounts.** Corporations which write the kinds of insurance below must maintain the following special accounts. A corporation which writes:

1. Mortgage guaranty insurance, must maintain a mortgage guaranty account;

2. Lease guaranty insurance, must maintain a lease guaranty account; and

3. Insurance on obligations the interest on which is excludable from gross income under section 103, must maintain an account with respect to insurance on state and local obligations.

Amounts required to be subtracted from these accounts under sections 832(e)(5) and 832(e)(6) must be reported as income on line 9. See section 832(e) for more information.

**Line 10. Income from protection against loss account.** Although section 1024 of P.L. 99-514 repealed section 824 relating to the protection against loss account (PAL account), PAL account balances are includable in income as though section 824 were still in effect.

Attach a schedule showing the computation.

**Line 11. Mutual interinsurers or reciprocal underwriters—decrease in subscriber accounts.** Enter the decrease for the tax year in savings credited to subscriber accounts of a mutual insurance company that is an interinsurer or reciprocal underwriter.

**Line 12. Income from a special loss discount account.** Enter the amount from Form 8816, Part I, line 6. See section 847(5) and the instructions for Form 8816 for more information.

**Line 13. Other income.** Enter any other taxable income not reported on lines 1 through 12. List the type and amount of income on an attached schedule. If the corporation has only one item of other income, describe it in parentheses on line 13. Examples of other income to report on line 13 are:

- The amount of any deduction previously taken under section 179A that is subject to recapture. The corporation must recapture the benefit of any allowable deduction for qualified clean-fuel vehicle property (or clean-fuel vehicle refueling property) if the property later ceases to qualify. See Regulations section 1.179-1 for details.

- Ordinary income from trade or business activities of a partnership (from Schedule K-1 (Form 1065 or Form 1065-B)).

## Deductions

**Reducing certain expenses for which credits are allowable.** For each credit listed below, the corporation must reduce the otherwise allowable deductions for expenses used to figure the credit by the amount of the current year credit:

1. Work opportunity credit.
2. Research credit.
3. Enhanced oil recovery credit.
4. Disabled access credit.
5. Empowerment zone employment credit.
6. Indian employment credit.
7. Employer credit for social security and Medicare taxes paid on certain employee tips.
8. Orphan drug credit.
9. Welfare-to-work credit.

If the corporation has any of these credits, be sure to figure each current year's credit before figuring the deduction for expenses on which the credit is based.

**Line 15. Compensation of officers.** Attach a schedule for all officers using the following columns:

1. Name of officer;
2. Social security number;
3. Percentage of time devoted to business;
4. Amount of compensation.

This information must be submitted by each member of an affiliated group included in a consolidated return.

**Disallowance of deduction for employee compensation in excess of \$1 million.** Publicly-held corporations may not deduct compensation to a "covered employee" to the extent that the compensation exceeds \$1 million. Generally, a covered employee is:

- The chief executive officer of the corporation (or an individual acting in that capacity) as of the end of the tax year, or
- An employee whose total compensation must be reported to shareholders under the Securities Exchange Act of 1934 because the employee is among the four highest compensated officers for that tax year (other than the chief executive officer).

For this purpose, compensation does not include the following:

- Income from certain employee trusts, annuity plans, or pensions; and
- Any benefit paid to an employee that is excluded from the employee's income.

The deduction limit does not apply to:

- Commissions based on individual performance;
- Qualified performance-based compensation; and
- Income payable under a written, binding contract in effect on February 17, 1993.

The \$1 million limit is reduced by amounts disallowed as excess parachute payments under section 280G.

For details, see section 162(m) and Regulations section 1.162-27.

**Line 16. Salaries and wages.** Enter the amount of salaries and wages paid for the tax year, reduced by:

- Any work opportunity credit from Form 5884,
- Empowerment zone employment credit from Form 8844,
- Indian employment credit from Form 8845.
- Any welfare-to-work credit from Form 8861.

See the instructions for these forms for more information. Do not include salaries and wages deductible elsewhere on the return, such as elective contributions to a section 401(k) cash or deferred arrangement, or amounts contributed under a salary reduction SEP agreement or a SIMPLE IRA plan.



*If the corporation provided taxable fringe benefits to its employees, such as the personal use of a car, do not deduct as wages the amount allocated for depreciation and other expenses that are claimed elsewhere on its return.*

**Line 18. Rents.** If the corporation rented or leased a vehicle, enter the total annual rent or lease expense paid or incurred during the year. Also complete Part V of **Form 4562**, Depreciation and Amortization. If the corporation leased a vehicle for a term of 30 days or more, the deduction for the vehicle lease expense may have to be reduced by an amount called the **inclusion amount**. The

corporation may have an inclusion amount if:

	And the vehicle's fair market value on the first day of the lease exceeded:
After 12/31/98 .....	\$15,500
After 12/31/96 but before 1/1/99.....	\$15,800
After 12/31/94 but before 1/1/97.....	\$15,500
After 12/31/93 but before 1/1/95.....	\$14,600

If the lease term began before January 1, 1994 or, the corporation leased an electric vehicle, see **Pub. 463**, Travel, Entertainment, Gift and Car Expenses, to find out if the corporation has an inclusion amount. Also see Pub. 463 for instructions on figuring the inclusion amount.

**Line 19. Taxes and licenses.** Enter taxes paid or accrued during the tax year, but do not include the following:

- Federal income taxes.
- Foreign or U.S. possession income taxes if a credit is claimed (however, see the instructions for Form 5735 for special rules for possession income taxes).
- Taxes not imposed on the corporation.
- Taxes, including state or local sales taxes, that are paid or incurred in connection with an acquisition or disposition of property. (These taxes must be treated as a part of the cost of the acquired property or, in the case of a disposition, as a reduction in the amount realized on the disposition.)
- Taxes assessed against local benefits that increase the value of the property assessed (such as for paving, etc.)

See section 164(d) for the apportionment of taxes on real estate between a seller and a purchaser.

**Line 20a. Interest.**

**Note:** *The deduction for interest is limited when the corporation is a policyholder or beneficiary with respect to a life insurance, endowment, or annuity contract issued after June 8, 1997. For details, see section 264(f). Attach a statement showing the computation of the deduction.*

The corporation must make an interest allocation if the proceeds of a loan were used for more than one purpose (e.g., to purchase a portfolio investment and to acquire an interest in a passive activity). See Temporary Regulations section 1.163-8T for the interest allocation rules.

**Do not** deduct the following interest:

- Interest on indebtedness incurred or continued to purchase or carry obligations if the interest is wholly exempt from income tax. For exceptions, see section 265(b).
- Interest and carrying charges on straddles. Generally, these amounts must be capitalized. See section 263(g).
- Interest on debt allocable to the production of designated property by a corporation for its own use or for sale. The corporation must capitalize this interest. Also capitalize any interest on debt allocable to an asset used to produce the property. See section 263A and Regulations section 1.263A-8 through

1.263A-15 for definitions and more information.

Special rules apply to:

- Interest on which no tax is imposed (see section 163(j)).
- Foregone interest on certain below-market-rate loans (see section 7872).
- Original issue discount on certain high-yield discount obligations (See section 163(e) to figure the disqualified portion.)

**Line 20b. Less tax-exempt interest expense.** Enter interest paid or accrued during the tax year on indebtedness incurred or continued to purchase or carry obligations if the interest is wholly exempt from income tax. For exceptions, see section 265(b).

**Line 21. Charitable contributions.** Enter contributions or gifts actually paid in the tax year to or for the use of charitable and governmental organizations described in section 170(c), and any unused contributions carried over from prior years.

Corporations reporting taxable income on the accrual method may elect to treat as paid during the tax year any contributions paid by the 15th day of the 3rd month after the end of the tax year if the contributions were authorized by the board of directors during the tax year. Attach a declaration to the return, signed by an officer, stating that the resolution authorizing the contributions was adopted by the board of directors during the tax year. Also attach a copy of the resolution.

**Limitation on deduction.** The total amount claimed may not be more than 10% of taxable income (line 37, Schedule A) computed without regard to the following:

- Any deduction for contributions,
- The deduction for dividends received,
- The deduction allowed under section 249,
- Any net operating loss (NOL) carryback to the tax year under section 172, and
- Any capital loss carryback to the tax year under section 1212(a)(1).

**Carryover.** Charitable contributions over the 10% limitation may not be deducted for the tax year but may be carried over to the next 5 tax years.

Special rules apply if the corporation has an NOL carryover to the tax year. In figuring the charitable contributions deduction for the tax year, the 10% limit is applied using the taxable income after the deduction for NOL.

To figure the amount of any remaining NOL carryover to later years, taxable income must be modified (see section 172(b)). To the extent that contributions are used to reduce taxable income for this purpose and increase an NOL carryover, a contributions carryover is not allowed. See section 170(d)(2)(B).

**Substantiation requirements.** Generally, no deduction is allowed for any contribution of \$250 or more unless the

corporation obtains a written acknowledgment from the donee organization that shows the amount of cash contributed, describes any property contributed, and either gives a description and a good faith estimate of the value of any goods or services provided in return for the contribution, or states that no goods or services were provided in return for the contribution. The acknowledgment must be obtained by the due date (including extensions) of the corporation's return, or if earlier, the date the return is filed. Do not attach the acknowledgment to the tax return, but keep it with the corporation's records. These rules apply in addition to the filing requirements for Form 8283 described below.

For more information on substantiation and recordkeeping requirements, see the regulations under section 170 and **Pub. 526**, Charitable Contributions.

**Contributions to organizations conducting lobbying activities.**

Contributions made to an organization that conducts lobbying activities are not deductible if:

- The lobbying activities relate to matters of direct financial interest to the donor's trade or business, and
- The principal purpose of the contribution was to avoid Federal income tax by obtaining a deduction for activities that would have been nondeductible under the lobbying expense rules if conducted directly by the donor.

**Contribution of property other than cash.** If a corporation (other than a closely held corporation) contributes property other than cash and claims over a \$500 deduction for the property, it must attach a schedule to the return describing the kind of property contributed and the method used to determine its fair market value.

Closely-held corporations generally must complete **Form 8283**, Noncash Charitable Contributions, and attach it to their returns. All other corporations generally must complete and attach Form 8283 to their returns for contributions of property (other than money) if the total claimed deduction for all property contributed was more than \$5,000.

If the corporation made a "qualified conservation contribution" under section 170(h), also include the fair market value of the underlying property before and after the donation, as well as the type of legal interest contributed, and describe the conservation purpose benefited by the donation. If a contribution carryover is included, show the amount and how it was determined.

**Reduced deduction for contributions of certain property.** For a charitable contribution of property, the corporation must reduce the contribution by the sum of:

- The ordinary income and short-term capital gain that would have resulted if the property had been sold at its fair market value, and

- For certain contributions, the long-term capital gain that would have resulted if the property were sold at its fair market value.

The reduction for long-term capital gain applies to:

- Contributions of tangible personal property for use by an exempt organization for a purpose or function unrelated to the basis for its exemption, and
- Contributions of any property to or for the use of certain private foundations, except for stock for which market quotations are readily available (see section 170(e)(5)).

**Larger deduction.** A larger deduction is allowed for certain contributions of:

- Inventory and other property to certain organizations for use in the care of the ill, needy, or infants (see section 170(e)(3) and Regulations section 1.170A-4A);
- Scientific equipment used for research to institutions of higher learning or to certain scientific research organizations (other than by personal holding companies and service organizations) (see section 170(e)(4));
- Computer technology and equipment to schools.

**Contributions of computer technology and equipment to schools.**

A corporation may take an increased deduction under section 170(e)(6) for qualified contributions of computer technology or equipment for elementary or secondary school purposes. A contribution is a qualified contribution if:

- It is made to an eligible donee (see below)
- Substantially all of the donee property use is:
  1. Related to the purpose or function of the donee;
  2. For use within the United States; and
  3. For educational purposes in any grade K–12.
- The contribution is made not later than 2 years after the date the taxpayer acquired or substantially completed the construction of the property;
- The original use of the property is by the donor or the donee;
- The property is not transferred by the donee for money, services, or other property, except for shipping, transfer, and installation costs; and
- The property fits productively into the donee's education plan.

**Eligible donee.** The term “eligible donee” means:

- An educational organization that normally maintains a regular faculty and curriculum and has a regularly enrolled body of pupils in attendance at the place where its educational activities are regularly conducted; or
- A section 501(c)(3) entity organized primarily for purposes of supporting elementary and secondary education.

**Note:** *Contributions of computer technology or equipment to private foundations may be treated as qualified elementary or secondary educational contributions if certain requirements are met. See section 170(e)(6)(C).*

**Line 22. Depreciation.** Besides depreciation, include on line 22 the part of the cost that the corporation elected to expense under section 179 for certain tangible property placed in service during tax year 1999 or carried over from 1998. See **Form 4562**, Depreciation and Amortization and its instructions.

**Line 23. Depletion.** See sections 613 and 613A for percentage depletion rates applicable to natural deposits. Also, see section 291 for the limitation on the depletion deduction for iron ore and coal (including lignite).

Attach **Form T (Timber)**, Forest Activities Schedules, if a deduction for depletion of timber is taken.

Foreign intangible drilling costs and foreign exploration and development costs must either be added to the corporation's basis for cost depletion purposes or be deducted ratably over a 10-year period. See sections 263(i), 616, and 617 for details.

**Line 24. Pension, profit-sharing, etc., plans.** Enter the deduction for contributions to qualified pension, profit-sharing, or other funded deferred compensation plans. Employers who maintain such a plan generally must file one of the forms listed below, even if the plan is not a qualified plan under the Internal Revenue Code. The filing requirement applies even if the corporation does not claim a deduction for the current tax year. There are penalties for failure to file these forms on time and for overstating the pension plan deduction. See sections 6652(e) and 6662(f).

**Form 5500**, Annual Return/Report of Employee Benefit Plan. File this form for a plan that is not a one-participant plan (see below).

**Form 5500-EZ**, Annual Return of One-Participant (Owners and Their Spouses) Retirement Plan. File this form for a plan that only covers the owner (or the owner and his or her spouse) but only if the owner (or the owner and his or her spouse) owns the entire business.

**Line 25. Employee benefit programs.** Enter contributions to employee benefit programs not claimed elsewhere on the return (e.g., insurance, health and welfare programs etc.) that are not an incidental part of a pension, profit-sharing, etc., plan included on line 24.

**Line 27. Additional deduction.** Enter the total from Form 8816, Part I, line 5.

Any insurance company taking the additional deduction **MUST**:

- Make special estimated tax payments equal to the tax benefit from the deduction, **and**

- Establish and maintain a Special Loss Discount Account. See section 847 and Form 8816 for more information.

**Line 29. Dividends to policyholders.** Enter the total **dividends and similar distributions** paid or declared to policyholders, as policyholders, except in the case of a mutual fire insurance company exclusively issuing perpetual policies. Whether dividends have been paid or declared should be determined according to the method of accounting employed by the insurance company.

**Dividends and similar distributions** include amounts returned or credited to policyholders on cancellation or expiration of policies issued by a mutual fire or flood insurance company:

1. Where the premium deposits for the policy are the same (regardless of the length of the policy), and

2. The unabsorbed portion of the premium deposits not required for losses, expenses, or establishment of reserves is returned or credited to the policyholder on cancellation or expiration of the policy.

In the case of a qualified group self-insurers fund, the fund's deduction for policyholder dividends is allowed no earlier than the date the state regulatory authority determines the amount of the policyholder dividend that may be paid. See section 6076 of the Technical and Miscellaneous Revenue Act of 1988 (“Act of 1988”).

**Line 30. Mutual interinsurers or reciprocal underwriters—increase in subscriber accounts.** A mutual insurance company that is an interinsurer or reciprocal underwriter may deduct the increase in **savings credited to subscriber accounts** for the tax year.

**Savings credited to subscriber accounts** means the surplus credited to the individual accounts of subscribers before the 16th day of the 3rd month following the close of the tax year. This is true only if the corporation would be required to pay this amount promptly to a subscriber if the subscriber ended the contract when the corporation's tax year ends. The corporation must notify the subscriber as required by Regulations section 1.823-6(c)(2)(v). The subscriber must treat any savings credited to the subscriber's account as a dividend paid or declared.

**Line 31. Other deductions**

**Note:** *Do not deduct fines or penalties paid to a government for violating any law.*

Attach a schedule listing by type and amount, all deductions allowable under sections 832(c)(1) and (10) (net of the annual statement change in undiscounted unpaid loss adjustment expenses) that are not deductible on lines 15 through 30. Examples of amounts to include are:

- Ordinary losses from trade or business activities of a partnership (from Schedule K-1 (Form 1065 or 1065-B)).
- Dividends paid in cash on stock held by an employee stock ownership plan.

However, a deduction may only be taken if, according to the plan, the dividends are:

1. Paid in cash directly to the plan participants or beneficiaries;
2. Paid to the plan which distributes them in cash to the plan participants or their beneficiaries no later than 90 days after the end of the plan year in which the dividends are paid; or
3. Used to make payments on a loan described in section 404(a)(9).

See section 404(k) for more details and the limitation on certain dividends.

#### **Travel, meals, and entertainment.**

Subject to limitations and restrictions discussed below, a corporation can deduct ordinary and necessary travel, meal, and entertainment expenses paid or incurred in its trade or business. Also, special rules apply to deductions for gifts, skybox rentals, luxury water travel, convention expenses, and entertainment tickets. See section 274 and Pub. 463 for more details.

**Travel.** The corporation cannot deduct travel expenses of any individual accompanying a corporate officer or employee, including a spouse or dependent of the officer or employee, unless:

- That individual is an employee of the corporation, and
- His or her travel is for a bona fide business purpose and would otherwise be deductible by that individual.

**Meals and entertainment.** Generally, the corporation can deduct only 50% of the amount otherwise allowable for meals and entertainment expenses paid or incurred in its trade or business. In addition (subject to exceptions under section 274(k)(2)):

- Meals must not be lavish or extravagant;
- A bona fide business discussion must occur during, immediately before, or immediately after the meal; and
- An employee of the corporation must be present at the meal.

See section 274(n)(3) for a special rule that applies to expenses for meals consumed by individuals subject to the hours of service limits of the Department of Transportation.

**Membership dues.** The corporation may deduct amounts paid or incurred for membership dues in civic or public service organizations, professional organizations (such as bar and medical associations), business leagues, trade associations, chambers of commerce, boards of trade, and real estate boards. However, no deduction is allowed if a principal purpose of the organization is to entertain, or provide entertainment facilities for, members and their guests. In addition, corporations may not deduct membership dues in any club organized for business, pleasure, recreation, or other social purpose. This includes country clubs, golf and athletic clubs, airline and hotel clubs,

and clubs operated to provide meals under conditions favorable to business discussion.

**Entertainment facilities.** The corporation cannot deduct an expense paid or incurred for a facility (such as a yacht or hunting lodge) used for an activity that is usually considered entertainment, amusement, or recreation.

**Note:** *The corporation may be able to deduct otherwise nondeductible meals, travel, and entertainment expenses if the amounts are treated as compensation and reported on Form W-2 for an employee or on Form 1099-MISC for an independent contractor.*

**Deduction for clean-fuel vehicles and certain refueling property.** Section 179A allows a deduction for part of the cost of qualified clean-fuel vehicle property and qualified clean-fuel vehicle refueling property placed in service during the tax year. For more information, see Pub. 535.

**Lobbying expenses.** Generally, lobbying expenses are not deductible. These expenses include:

- Amounts paid or incurred in connection with influencing Federal or state legislation (but not local legislation), or
- Amounts paid or incurred in connection with any communication with certain Federal executive branch officials in an attempt to influence the official actions or positions of the officials. See Regulations section 1.162-29 for the definition of "influencing legislation."

Dues and other similar amounts paid to certain tax-exempt organizations may not be deductible. See section 162(e)(3). If certain in-house expenditures do not exceed \$2,000, they are deductible. For information on contributions to charitable organizations that conduct lobbying activities, see the instructions for Schedule A, line 21. For more information on lobbying expenses, see section 162(e).

**Line 32. Total deductions.** Insurance companies that issue specified insurance contracts (as defined in section 848(e)(1)) are generally required to amortize policy acquisition expenses on a straight-line basis over a period of 120 months beginning with the 1st month in the 2nd half of the tax year (section 848(a)). Reduce total deductions on line 32 by the amount required to be capitalized under section 848. Attach a schedule showing all computations. See section 848 and its regulations for special rules, definitions, and exceptions. Also see Schedule G, Form 1120-L, and its instructions for more information.

**Line 34b. Deduction on account of the special income and deduction accounts.** Enter the total of the amounts required to be added under sections 832(e)(4) and (6). However, no deduction is permitted unless tax and loss bonds are purchased in an amount equal to the tax benefit of the deduction. See section 832(e).

**Note:** *The deduction on account of the special income and deduction accounts is limited to taxable income for the tax year (computed without regard to this deduction or to any carryback of a net operating loss).*

#### **Line 36b. Net operating loss deduction.**

A corporation may use the net operating loss (NOL) incurred in one tax year to reduce its taxable income in another year. Generally, a corporation may carry an NOL back to each of the 2 years (3 years for NOLs incurred in tax years beginning before August 6, 1997), preceding the year of the loss and then carry any remaining amount over to each of the 20 years (15 years for NOLs incurred in tax years beginning before August 6, 1997), following the year of the loss (but see **Waiving the carryback period** on page 13).

Enter on line 36b, the total NOL carryovers from prior tax years, but do not enter more than the corporation's taxable income (after dividends-received deduction). An NOL deduction cannot be taken in a year in which the corporation has negative taxable income. Attach a schedule showing the computation of the NOL deduction. Also complete question 15 on Schedule I.

For details on the NOL deduction, see **Pub. 536, Net Operating Losses.**

**Carryback and carryover rules.** To carry back the loss and obtain a quick refund of taxes, use **Form 1139, Corporation Application for Tentative Refund.** Form 1139 must be filed within 12 months after the close of the tax year of the loss. See section 6411 for details. Do not attach Form 1139 to the corporation's income tax return. Mail it in a separate envelope to the service center where the corporation files its income tax return.

For carryback claims filed later than 12 months after the close of the tax year of the loss, file an amended Form 1120-PC instead of Form 1139.

After the corporation has applied the NOL to the first tax year to which it may be carried, the taxable income of that year is modified (as described in section 172(b)) to determine how much of the remaining loss may be carried to other years. See section 172(b) and the related regulations for details.

**Special NOL rules** apply when:

- An ownership change occurs (i.e., the amount of the taxable income of a loss corporation that can be offset by pre-change NOL carryovers is limited) See section 382 and the related regulations. Also see Temporary Regulations section 1.382-2T(a)(2)(ii), which requires that a loss corporation file an information statement with its income tax return for each tax year that it is a loss corporation and certain shifts in ownership occurred. See Regulations section 1.382-6(b) for details on how to make the closing-of-the-books election.
- A corporation acquires control of another corporation (or acquires its assets

in a reorganization) and the amount of pre-acquisition losses that may offset recognized built-in gains is limited. See section 384.

**Waiving the carryback period.** A corporation may make an irrevocable election to forego the carryback period and instead carry the NOL forward to years following the year of the loss. To make this election, check the box in question 14 on Schedule I. The return must be timely filed (including extensions).

An NOL cannot be carried to or from any tax year for which the insurance company is not subject to tax under section 831(a), or to any tax year if (between the tax year from which the loss is being carried and such tax year) there is an intervening tax year for which the insurance company was not subject to tax imposed by section 831(a).

See section 844 for special loss carryover rules for insurance companies.

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## Schedule B, Part I — Taxable Investment Income of Electing Small Companies

**Note:** (1) Once an election under section 831(b) is made to be taxed only on investment income, it can only be revoked with the consent of the Secretary, and (2) a corporation making this election must include on line 8, gross investment income, any amount subtracted from a protection against loss account.

### Income

#### Line 1a, column (a). Gross interest.

Enter the gross amount of interest income including all tax-exempt interest income.

**Line 1b, column (a). Interest exempt under section 103.** Enter the amount of interest on state and local bonds that is exempt from taxation under section 103. See the instructions for Schedule A, line 3b, column (a), for more information.

#### Lines 1a and 1b, column(b).

**Amortization of premiums.** Enter on line 1a, column (b), the total amortization of premium on tax-exempt bonds.

Enter on line 1b, column (b), the amortization of bond premium on tax-exempt bonds.

**Note:** Insurance companies electing to amortize discount for tax purposes must reduce the amortization of premium by any amortization of discount.

**Line 3. Gross rents.** Enter the gross rents received or accrued during the tax year. Deduct rental expenses such as repairs, interest, taxes and depreciation on the proper lines in the **Deductions** section.

**Line 5. Gross income from a trade or business, other than an insurance business, and from Form 4797.** Enter the gross income from a trade or business, other than an insurance business, carried on by the insurance

company or by a partnership of which the insurance company is a partner. Include section 1245 and section 1250 gains (as modified by section 291), and other gains from **Form 4797**, Sales of Business Property, on investment assets only.

**Line 6. Income from leases described in sections 834(b)(1)(B) and 834(b)(1)(C).** Enter gross income from entering into, changing, or ending any lease, mortgage, or other instrument or agreement from which the company earns interest, rents, or royalties.

**Line 8. Gross investment income.** If gross investment income includes an amount subtracted from the protection against loss account, write on the dotted line next to line 8, "PAL" and the amount.

### Deductions

**Note:** See section 834(d)(1) regarding the limitation of expenses on real estate owned and occupied in part or in whole by a mutual insurance company.

**Line 9. Real estate taxes.** Enter taxes paid or accrued on real estate owned by the corporation and deductible under section 164.

**Line 10. Other real estate expenses.** Enter all ordinary and necessary real estate expenses, such as fire insurance, heat, light, and labor. Also enter the cost of incidental repairs, such as labor and supplies, that do not add to the property's value nor appreciably prolong its life. Do not include any amount paid for new buildings or for permanent improvements or betterments made to increase the value of any property or any amount spent on foreclosed property before the property is held for rent.

**Line 11. Depreciation.** Enter depreciation on assets only to the extent that the assets are used to produce gross investment income reported on lines 1 through 7 of Schedule B. For more information, see the instructions for line 22, Schedule A.

**Line 12. Depletion.** Enter any allowable depletion on royalty income reported on line 4, Schedule B. See the instructions for line 23, Schedule A, for more information.

**Line 13. Trade or business deductions.** Enter the total deductions related to any trade or business income included in gross investment income under section 834(b)(2). Do not include deductions for any insurance business. Do not include losses from sales or exchanges of capital assets or property used in the business, or from the compulsory or involuntary conversion of property used in the trade or business.

**Line 14. Interest.** See the instructions for lines 20a and 20b, Schedule A.

**Line 17. Investment expenses.** Enter expenses that are properly chargeable as investment expenses. If general expenses are allocated to investment expenses, the total deduction cannot be more than the amount on Schedule B, Part II, line 39. Attach a schedule showing the kind and

amount of general expenses. Minor items may be grouped together.

See section 267 for the limitation on deductions for unpaid expenses and interest in transactions between related taxpayers.

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## Schedule B, Part II — Invested Assets Book Values

Use Schedule B, Part II, to compute the limitation on investment expenses under section 834(c)(2) when any general expenses are in part assigned to, or included in, the investment expenses deducted on Schedule B, Part I, line 17.

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## Schedule C — Dividends and Special Deductions

### Definitions

The **acquisition date** for investments acquired by direct purchase, is the trade date rather than the settlement date. For investments not acquired by direct purchase (such as those acquired through transfers among affiliates, tax-free reorganizations, or the liquidation of a subsidiary, etc.), the actual acquisition date should be used regardless of the holding period determined under section 1223.

A special rule applies in determining the acquisition date of dividends received from affiliates. This rule provides that the portion of any 100% dividend which is related to prorated amounts be treated as received with respect to stock acquired on the later of:

(a) the date the payor acquired the stock or obligation to which the prorated amounts are attributable, or

(b) the first day on which the payor and payee were members of the same affiliated group as defined in section 243(b).

Also, if the taxpayer is a member of an affiliated group filing a consolidated return, its determination of dividends received is made as if the group were not filing a consolidated return.

**Prorated amounts** means tax-exempt interest and dividends for which a deduction is allowable under section 243, 244, or 245 (other than 100% dividends).

**100% dividend** means any dividend if the percentage used for purposes of determining the deduction allowable under section 243, 244, or 245(b) is 100%. A special rule applies to certain dividends received by a foreign corporation.

### Lines 1 through 23

For purposes of the 20% ownership test on lines 1 through 7, the percentage of stock owned by the corporation is based on voting power and value of the stock. Preferred stock described in section 1504(a)(4) is not taken into account. Corporations filing a consolidated return

should see Regulations sections 1.1502-13, 1.1502-26 and 1.1502-27 before completing Schedule C.

**Lines 1 through 9, column (a).** Enter in column (a) of the appropriate line those dividends that are subject to the provisions of section 832(b)(5)(B). This will include:

1. All dividends (other than 100% dividends) received on stock acquired after August 7, 1986; and
2. 100% dividends received on stock acquired after August 7, 1986, to the extent that such dividends are attributable to prorated amounts (see definition above).

In the case of an insurance company that files a consolidated return, the determination with respect to any dividend paid by a member to another member of the affiliated group is made as if no consolidated return was filed. See section 832(g).

**Line 1.** Enter dividends (except those received on debt-financed stock acquired after July 18, 1984—see section 246A) received from less-than-20%-owned domestic corporations subject to income tax, and qualify for the 70% deduction under section 243(a)(1). Include on this line taxable distributions from an IC-DISC or former DISC that are designated as eligible for the 70% deduction and certain dividends of Federal Home Loan Banks. See section 246(a)(2).

Also include on line 1 dividends (except those received on debt-financed stock acquired after July 18, 1984) from a regulated investment company (RIC). The amount of dividends eligible for the dividends-received deduction under section 243 is limited by section 854(b). The corporation should receive a notice from the RIC specifying the amount of dividends that qualify for the deduction.

Report so-called dividends or earnings received from mutual savings banks, etc., as interest. Do not treat them as dividends.

**Line 2.** Enter dividends (except those received on debt-financed stock acquired after July 18, 1984) that are received from 20%-or-more-owned domestic corporations subject to income tax and that are subject to the 80% deduction under section 243(c).

Include on this line taxable distributions from an IC-DISC or former DISC that are considered eligible for the 80% deduction.

**Line 3.** Enter dividends received on debt-financed stock acquired after July 18, 1984, from domestic and foreign corporations subject to income tax that would otherwise be subject to the dividends-received deduction under section 243(a)(1), 243(c), or 245(a). Generally, debt-financed stock is stock that the corporation acquired by incurring a debt (e.g., it borrowed money to buy the stock).

Include on line 3 dividends received from a regulated investment company (RIC) on debt-financed stock. The amount

of dividends eligible for the dividends-received deduction is limited by section 854(b). The corporation should receive a notice from the RIC specifying the amount of dividends that qualify for the deduction.

**Line 4.** Enter dividends received on the preferred stock of a less-than-20%-owned public utility that is subject to income tax and is allowed the deduction provided in section 247 for dividends paid.

**Line 5.** Enter dividends received on preferred stock of a 20%-or-more-owned public utility that is subject to income tax and is allowed the deduction provided in section 247 for dividends paid.

**Line 6.** Enter the U.S. source portion of dividends received from less-than-20%-owned foreign corporations that qualify for the 70% deduction under section 245(a). To qualify for the 70% deduction, the corporation must own at least 10% of the foreign corporation by vote and value. Also include dividends received from a less-than-20% owned foreign sales corporation (FSC) that are attributable to income treated as effectively connected with the conduct of a trade or business within the United States (excluding foreign trade income) and that qualify for the 70% deduction provided in section 245(c)(1)(B).

**Line 7.** Enter the U.S.-source portion of dividends received from 20%-or-more-owned foreign corporations and that qualify for the 80% deduction under section 245(a). Also include dividends received from a 20%-or-more-owned FSC that are attributable to income treated as effectively connected with the conduct of a trade or business within the United States (excluding foreign trade income) and that qualify for the 80% deduction provided in section 245(c)(1)(B).

**Line 8.** Enter dividends received from wholly owned foreign subsidiaries that are eligible for the 100% deduction provided in section 245(b) and dividends from a FSC that qualify for the deduction provided in section 245(c)(1)(A). In general, the deduction under section 245(b) applies to dividends paid out of the earnings and profits of a foreign corporation for a tax year during which:

- All of its outstanding stock is owned (directly or indirectly) by the domestic corporation receiving the dividends, and
- All of its gross income from all sources is effectively connected with the conduct of a trade or business within the United States.

**Line 9.** Enter only those dividends that qualify under section 243(b) for the 100% dividends-received deduction described in section 243(a)(3). Corporations taking this deduction are subject to the provisions of section 1561.

**Note:** *The 100% deduction does not apply to affiliated group members that are joining in the filing of a consolidated return.*

**Line 10, column (b).** Enter foreign dividends not reportable on lines 6, 7, and 8. Include on line 10 the corporation's share of the ordinary earnings of a qualified electing fund from Form 8621, line 1c. Exclude distributions of amounts constructively taxed in the current year or in prior years under subpart F (sections 951 through 964).

**Line 11, column (b).** Include income constructively received from controlled foreign corporations under subpart F. This amount should equal the total amounts subpart F income on Schedule I of Form 5471.

**Line 12, column (b).** Include gross-up for taxes deemed paid under sections 902 and 960.

**Line 13, column (b).** Include the following:

1. Dividends (other than capital gain and exempt-interest dividends) that are received from regulated investment companies and are not subject to the 70% deduction.
2. Dividends from tax-exempt organizations.
3. Dividends (other than capital gain dividends) received from a real estate investment trust that, for the tax year of the trust in which the dividends are paid, qualifies under sections 856 through 860.
4. Dividends not eligible for a dividends-received deduction because of the holding period of the stock or an obligation to make corresponding payments with respect to similar stock.

Two situations in which the dividends-received deduction will not be allowed on any share of stock are:

- If the corporation held it for less than 46 days during the 90-day period beginning 45 days before the stock became ex-dividend with respect to the dividend (see section 246(c)(1)(A)), or
- To the extent the corporation is under an obligation to make related payments for substantially similar or related property.

5. Any other taxable dividend income not properly reported above (including distributions under section 936(h)(4)).

**Line 17.** Dividends received on debt-financed stock acquired after July 18, 1984, are not entitled to the full 70% or 80% dividends-received deduction. The 70% or 80% deduction is reduced by a percentage that is related to the amount of debt incurred to acquire the stock. See section 246A. Also see section 245(a) before making this computation for an additional limitation which applies to dividends received from foreign corporations.

Attach a schedule showing how the amount on line 17 was figured.

**Line 23. Limitations on Dividends-Received Deduction**

Generally, line 23, column (b) may not exceed the amount from the worksheet on page 15. However, in a year in which

an NOL occurs, this limitation does not apply even if the loss is created by the dividends-received deduction. See sections 172(d) and 246(b).

**Worksheet for Schedule C, line 23**  
(keep for your records)

1. Enter the amount from Schedule A, line 37 or Schedule B, line 21, whichever applies, without: the NOL deduction (section 172); dividend-received deduction (sections 243(a)(1), 244(a), 245(a) or (b), and 247); any adjustment under section 1059; and any capital loss carryback to the tax year under section 1212(a)(1).....
2. Enter the sum of the amounts from line 22, column (b), (without regard to wholly owned foreign subsidiary dividends) and line 9, column (b).....
3. Subtract line 2 from line 1.....
4. Multiply line 3 by 80%.....
5. Add lines 16, 19, 21, and 22 (without regard to FSC dividends), column (b) and the portion of the deduction on line 17, column (b) that is attributable to dividends received from 20% -or-more-owned corporations.....
6. Enter the smaller of line 4 or line 5. If line 5 is greater than line 4, stop here; enter the amount from line 6 on line 23, column (b) (without regard to FSC dividends). Do not complete the rest of this worksheet.....
7. Enter the total amount of dividends received from 20%-or-more-owned corporations that are included on lines 2, 3, 5, 7, and 8 (without regard to FSC dividends), column (b).....
8. Subtract line 7 from line 3.....
9. Multiply line 8 by 70%.....
10. Subtract line 5 from line 23, column (b) (without regard to FSC dividends).....
11. Enter the smaller of line 9 or line 10.....
12. **Dividends-received deduction after limitation (section 246(b)).** Add lines 6 and 11. Enter the result here and on line 23, column (b) (without regard to FSC dividends).....

**Schedule E — Premiums Earned**

**Definitions**

**Undiscounted unearned premiums** means the unearned premiums shown in the annual statement filed for the year ending with or in the tax year.

**Applicable interest rate** means the annual rate determined under section 846(c)(2) for the calendar year the premiums are received.

**Applicable statutory premium recognition pattern** means the statutory premium recognition pattern in effect for the calendar year the premiums are received, and is based on the statutory premium recognition pattern which applies to premiums received by the corporation in that calendar year. For purposes of the preceding sentence, premiums received during any calendar year will be treated as received in the middle of such year.

**Line 1.** Enter gross premiums written on insurance contracts during the tax year, less return premiums and premiums paid for reinsurance.

**Lines 2a and 4a.** Include on lines 2a and 4a:

1. All life insurance reserves, as defined in section 816(b) (but determined under section 807); and

2. All unearned premiums of a Blue Cross or Blue Shield organization to which section 833 applies.

**Lines 2b and 4b.** Include on lines 2b and 4b, 90% of unearned premiums for insurance against default in the payment of principal or interest on securities described in section 165(g)(2)(C) (relating to worthless securities) with maturities of more than 5 years.

**Lines 2c and 4c.** The amount of discounted unearned premiums at the end of any tax year must be the present value of those premiums (as of such time and separately with respect to premiums received in each calendar year) determined by using:

1. The amount of the undiscounted unearned premiums at such time;

2. The applicable interest rate; and

3. The applicable statutory premium recognition pattern.

**Lines 2d and 4d.** Include on lines 2d and 4d, 80% of the total of all unearned premiums not reported on lines 2a through 2c, or 4a through 4c, respectively.

A reciprocal or interinsurer required under state law to reflect unearned premiums on its annual statement net of premium acquisition expenses, should increase its unearned premiums by the amount of such acquisition expenses prior to making the computation on lines 2d and 4d. See section 832(b)(7)(E).

**Line 6.** Transitional adjustments apply to companies which become taxable under section 831(a). See section 832(b)(7)(D) for more information.

**Schedule F — Losses Incurred**

**Line 1. Losses paid.** Enter the total losses paid on insurance contracts during the tax year less salvage and reinsurance recovered during the tax year.

**Lines 2a and 4a. Unpaid losses on life insurance contracts.** Unpaid losses must be adjusted for recoveries of reinsurance. The amounts of expected recoveries should be estimated based on the facts in each case and the corporation's experience with similar cases. See Regulations section 1.832-4(b).

**Lines 2b and 4b. Discounted unpaid losses outstanding.** Enter all discounted unpaid losses as defined in section 846.

Section 846 provides that the amount of discounted unpaid losses must be computed separately by line of business (multiple peril lines must be treated as a single line of business) and by accident year and must be equal to the present value of such losses determined by using:

1. The amount of the undiscounted unpaid losses,

2. The applicable interest rate, and

3. The applicable loss payment pattern.

Special rules apply with respect to:

- Unpaid losses related to disability insurance (other than credit disability insurance),

- Noncancelable accident and health insurance,

- Cancelable accident and health insurance, and

- International and reinsurance lines of business.

With regard to the special rules for discounting unpaid losses on accident and health insurance (other than disability income insurance), unpaid losses are assumed to be paid in the middle of the year following the accident year.

Generally, the amount of undiscounted unpaid losses means the unpaid losses and unpaid loss adjustment expenses shown in the annual statement. However, see Regulations sections 1.846-1(a)(1) referring to Regulations section 1.832-4(b) relating to the determination of unpaid losses.

Under section 832(b)(5)(A), unpaid losses must be adjusted to take into account estimated recoveries due to salvage and reinsurance for those losses. If the amounts shown in the annual statement were determined on a discounted basis and if the extent to which these losses were discounted can be determined on the basis of information disclosed on or with the annual statement, the amount of the undiscounted unpaid losses must be recomputed to eliminate any reduction caused by such discounting. In no event can the amount of discounted unpaid losses with respect to any line of business for an accident year exceed the total amount of unpaid losses with respect to any line of business for an accident year as reported on the annual statement. Also see Regulations section 1.832-4(d) regarding increasing unpaid losses shown on the annual statement by salvage recoverable. Also see Rev. Proc. 92-77, 1992-2 C.B. 454.

The applicable interest rate for each calendar year and the applicable loss payment pattern for each accident year for each line of business are determined by the Secretary.

The applicable interest rates and loss payment pattern for 1997 and 1998 are published in Rev. Proc. 98-11, 1998-4 I.R.B. 9 and Rev. Proc. 99-15, 1999-7 I.R.B. 42. The applicable interest rate and loss payment patterns for 1999 are published in Rev. Proc. 99-36, 1999-42 I.R.B. 509.

Section 846(e) allows corporations having sufficient historical experience to determine a loss payment pattern to elect, under certain circumstances, to use their own historical experience. If this election is made, the loss payment patterns will be based on the most recent calendar

year for which an annual statement was filed before the beginning of the accident year. The election will not apply to any international or reinsurance line of business. If the corporation makes this election, check the "Yes" column for question 10 in Schedule I, Other Information. For more information, see section 846(e), Regulations section 1.846-2, and Rev. Proc. 92-76, 1992-2 C.B. 453.

**Note:** *There is a special application of the "Fresh Start" provision for an insurance company that is not subject to tax under section 831(a) for its first taxable year beginning after December 31, 1986, because (1) it is described in section 501(c) or (2) it is subject to tax under section 831(b) on its investment income.*

*If the insurance company later becomes subject to tax under section 831(a), the rules relating to the Fresh Start under the discounting provisions are applied by treating the last tax year before the year in which the insurance company becomes subject to tax under section 831(a) as the insurance company's last tax year beginning before 1987. See section 1010(e) of the Act of 1988 and Notice 88-100, 1988-2 C.B. 439.*

**Lines 6 and 7. Estimated salvage and reinsurance recoverable.** The salvage and reinsurance rates for 1997 and 1998 are published in Rev. Proc. 98-12, 1998-4 I.R.B. 18 and Rev. Proc. 99-16, 1999-7 I.R.B. 52. The 1999 estimated salvage and reinsurance rates are published in Rev. Proc. 99-37, 1999-42 I.R.B. 517. Also see Regulations section 1.832-4.

**Line 9. Tax-exempt interest subject to section 832(b)(5)(B).** Enter the amount of tax-exempt interest received or accrued during the tax year on investments made after August 7, 1986. For information regarding the determination of the acquisition date of an investment, see the instructions for Schedule C.

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## Schedule G — Other Capital Losses

Capital assets are considered sold or exchanged to provide funds to meet abnormal insurance losses and to pay dividends and make similar distributions to policyholders to the extent that the gross receipts from their sale or exchange are not more than the amount by which the sum of dividends and similar distributions paid to policyholders, losses paid, and expenses paid for the tax year is more than the total on line 9, Schedule G.

Total gross receipts from sales of capital assets (line 12, column (c)) must not be more than line 10. If necessary, the corporation may report part of the gross receipts from a particular sale of a capital asset on this schedule and the rest on

Schedule D (Form 1120). Otherwise, do not include on Schedule D (Form 1120) any sales reported on this schedule.

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## Schedule H — Special Deduction and Ending Adjusted Surplus for Section 833 Organizations

**Line 5. Beginning adjusted surplus.** If the corporation was a section 833 organization in 1998, it should enter the amount from Schedule H, line 10 of the 1998 Form 1120-PC.

Generally, the adjusted surplus as of the beginning of any tax year is an amount equal to the adjusted surplus as of the beginning of the preceding tax year:

1. Increased by the amount of any adjusted taxable income for the preceding tax year, or

2. Decreased by the amount of any adjusted net operating loss for the preceding tax year. If 1999 is the first tax year the taxpayer qualifies as a section 833 organization, see section 833(c)(3)(C) to determine the adjusted surplus as of the beginning of the 1999 tax year.

For purposes of the computation of the adjusted surplus, the terms "adjusted taxable income" and "adjusted net operating loss" mean the taxable income or the net operating loss, respectively, determined with the following modifications:

1. Without regard to the deduction determined under section 833(b)(1);

2. Without regard to any carryover or carryback to that tax year; and

3. By increasing gross income by an amount equal to the net exempt income for the tax year.

**Line 6. Special deduction.** The deduction for any tax year is limited to taxable income for that tax year determined without regard to this deduction.

**Note:** *Under section 833(b)(4), any determination under section 833(b) must be made by only taking into account items from the health-related business of the corporation.*

**Line 8a. Adjusted tax-exempt income.** Reduce the total tax-exempt interest received or accrued during the tax year by any amount (not otherwise deductible) which would have been allowable as a deduction for the tax year if such interest were not tax-exempt. Enter the result on line 8a.

**Line 8b. Adjusted dividends-received deduction.** Reduce the total amount allowed as a deduction under sections 243, 244, and 245 by the amount of any decrease in deductions allowable for the tax year because of section 832(b)(5)(B) when the decrease is caused by the deductions under sections 243, 244, and 245. Enter the result on line 8b.

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## Schedule I — Other Information

Be sure to answer all of the questions that apply to the corporation.

### Question 4

Check the "Yes" box for question 4 if :

- The corporation is a subsidiary in an affiliated group (defined below), but is not filing a consolidated return for the tax year with that group, or
- The corporation is a subsidiary in a parent-subsidiary controlled group (defined below).

Any corporation that meets either of the requirements above should check the "Yes" box. This applies even if the corporation is a subsidiary member of one group and the parent corporation of another.

**Note:** *If the corporation is an "excluded member" of a controlled group (see section 1563(b)(2)), it is still considered a member of a controlled group for this purpose.*

**Affiliated group.** The term "affiliated group" means one or more chains of includible corporations (section 1504(a)) connected through stock ownership with a common parent corporation. The common parent must be an includible corporation and the following requirements must be met:

1. The common parent must own directly stock that represents at least 80% of the total voting power and at least 80% of the total value of the stock of at least one of the other includible corporations.

2. Stock that represents at least 80% of the total voting power and at least 80% of the total value of the stock of each of the other corporations (except for the common parent) must be owned directly by at least one of the other includible corporations.

For this purpose, the term "stock" generally does not include any stock that:

1. Is nonvoting,
2. Is nonconvertible,
3. Is limited and preferred as to dividends and does not participate significantly in corporate growth, and
4. Has redemption and liquidation rights that do not exceed the issue price of the stock (except for a reasonable redemption or liquidation premium). See section 1504(a)(4).

**Parent-subsidiary controlled group.** The term "parent-subsidiary controlled group" means one or more chains of corporations connected through stock ownership (section 1563(a)(1)). Both of the following requirements must be met:

1. 80% of the total combined voting power of all classes of stock entitled to vote or at least 80% of the total value of all classes of stock of each corporation in the group (except the parent) must be owned by one or more of the other corporations in the group.

2. The common parent must own at least 80% of the total combined voting power of all classes of stock entitled to vote or at least 80% of the total value of all classes of stock of at least one of the other corporations in the group. Stock owned directly by other members of the group is not counted when computing the voting power or value.

See section 1563(d)(1) for the definition of "stock" for purposes of determining stock ownership above.

### Question 6

Check the "Yes" box if one foreign person owned at least 25% of (a) the total voting power of all classes of stock of the corporation entitled to vote, or (b) the total value of all classes of stock of the corporation.

The constructive ownership rules of section 318 apply in determining if a corporation is foreign-owned. See section 6038A(c)(5) and the related regulations.

Enter on line 6a the percentage owned by the foreign person specified in question 6. Enter on line 6b, the name of the owner's country.

**Note:** *If there is more than one 25%-or-more foreign owner, complete lines 6a and 6b for the foreign person with the highest percentage of ownership.*

**Foreign person.** The term "foreign person" means:

- A foreign citizen or nonresident alien.
- An individual who is a citizen of a U.S. possession (but who is not a U.S. citizen or resident).
- A foreign partnership.
- A foreign corporation.
- Any foreign estate or trust within the meaning of section 7701(a)(31).
- A foreign government (or one of its agencies or instrumentalities) to the extent that it is engaged in the conduct of a commercial activity as described in section 892.

**Owner's country.** For individuals, the term "owner's country" means the country of residence. For all others, it is the country where incorporated, organized, created, or administered.

**Requirement to file Form 5472.** If the corporation checked "Yes" to Question 6, it may have to file Form 5472. Generally, a 25% foreign-owned corporation that had a reportable transaction with a foreign or domestic related party during the tax year must file Form 5472.

See Form 5472 for filing instructions and penalties for failure to file.

### Question 8

**Foreign financial accounts.** Check the "Yes" box if either 1 or 2 below, applies to the corporation. Otherwise, check the "No" box:

1. At any time during the 1999 calendar year the corporation had an interest in or signature or other authority over a bank, securities, or other financial account in a foreign country; and

• The combined value of the accounts was more than \$10,000 at any time during the calendar year; AND

• The account was NOT with a U.S. military banking facility operated by a U.S. financial institution.

2. The corporation owns more than 50% of the stock in any corporation that would answer "Yes" to item 1 above.

Get **Form TD F 90-22.1**, Report of Foreign Bank and Financial Accounts, to see if the corporation is considered to have an interest in or signature or other authority over a financial account in a foreign country.

If "Yes" is checked for this question, file Form TD F 90-22.1 by June 30, 2000, with the Department of the Treasury at the address shown on the form. Because Form TD F 90-22.1 is not a tax form, do not file it with Form 1120-PC.

You can order Form TD F 90-22.1 from an IRS Distribution Center or by calling 1-800-TAX-FORM (1-800-829-3676).

Also, if "Yes" is checked for this question, enter the name of the foreign country or countries. Attach a separate sheet if more space is needed.

### Question 9

**Foreign trusts.** The corporation may be required to file **Form 3520**, Annual Return To Report Transactions with Foreign Trusts and Receipt of Certain Foreign Gifts, if:

- It directly or indirectly transferred money or property to a foreign trust. For this purpose, any U.S. person who created a foreign trust is considered a transferor.
- It is treated as the owner of any part of the assets of a foreign trust under the grantor trust rules.
- It received a distribution from a foreign trust.

For more information, see the instructions for Form 3520.

**Note:** *An owner of a foreign trust must ensure that the trust files an annual information return on Form 3520-A, Annual Information Return of Foreign Trust with a U.S. Owner. For details, see Form 3520-A.*

### Question 13

Show any **tax-exempt interest** received or accrued. Include any exempt-interest dividends received as a shareholder in a mutual fund or other regulated investment company.

### Question 14

Check the box on line 14 if the corporation elects under section 172(b)(3) to forgo the carryback period for a **net operating loss** (NOL). If you check this box, do not attach the statement described in Temporary Regulations section 301.9100-12T.

### Question 15

Enter the amount of the **net operating loss** (NOL) carryover to the tax year from prior years, even if some of the loss is

used to offset income on this return. The amount to enter is the total of all NOLs generated in prior years but not used to offset income (either as a carryback or carryover) to a tax year prior to 1999. Do not reduce the amount by any NOL deduction reported on Schedule A, line 36b. Pub. 536 has a worksheet for figuring a corporation's NOL carryover.

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## Schedule L — Balance Sheets Per Books

**Note:** *All insurance companies required to file Form 1120-PC must complete Schedule L.*

The balance sheet should agree with the corporation's books and records. Include certificates of deposit as cash on line 1 of Schedule L.

**Line 5. Tax-exempt securities.** Include on this line:

1. State and local government obligations, the interest on which is excludable from gross income under section 103(a), and

2. Stock in a mutual fund or other regulated investment company that distributed exempt-interest dividends during the tax year of the corporation.

**Line 18. Insurance liabilities.** Include on this line:

- Undiscounted unpaid losses,
- Loss adjustment expenses, and
- Unearned premiums.

See section 846 for more information.

**Line 27. Adjustments to shareholders' equity.** Some examples of adjustments to report on this line include:

- Unrealized gains and losses on securities held "available for sale".
- Foreign currency translation adjustments.
- The excess of additional pension liability over unrecognized prior service cost.
- Guarantees of employee stock (ESOP) debt.
- Compensation related to employee stock award plans.

If the total adjustment to be entered on line 27 is a negative amount, enter the amount in parentheses.

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## Schedule M-1 — Reconciliation of Income (Loss) per Books With Income per Return

**Line 5c. Travel and entertainment.** Include on line 5c any of the following:

- 50% of meals and entertainment not allowed under section 274(n).
- Expenses for the use of an entertainment facility.
- The part of business gifts over \$25.
- Expenses of an individual over \$2,000 which are allocable to conventions on cruise ships.

- Employee achievement awards over \$400.
- The cost of entertainment tickets over face value (also subject to 50% disallowance under section 274(n)).
- The cost of skyboxes over the face value of non-luxury box seat tickets.
- The part of luxury water travel not allowed under section 274(m).
- Expenses for travel as a form of education.
- Other travel and entertainment expenses not allowed as a deduction.

For more information, see Pub. 542.

**Line 7a. Tax exempt-interest.** Include as interest on line 7a any exempt-interest dividends received as a shareholder in a mutual fund or other regulated investment company.

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